

using the depreciation schedule based on your purchase price.

(3) If you are the original owner of the transportation system on June 1, 2000, or if you purchased your transportation system before March 1, 1988, you must continue to use your existing depreciation schedule in calculating actual transportation costs for production in periods after June 1, 2000.

(4) If you or your affiliate purchase a transportation system at arm's length from the original owner after June 1, 2000, you must base your depreciation schedule used in calculating actual transportation costs on your total capital investment in the system (including your original purchase price and subsequent reinvestment). You must prorate your depreciation for the year in which you or your affiliate purchased the system to reflect the portion of that year for which you or your affiliate own the system.

(5) If you or your affiliate purchase a transportation system at arm's length after June 1, 2000, from anyone other than the original owner, you must assume the depreciation schedule of the person from whom you bought the system. Include in the depreciation schedule any subsequent reinvestment.

(i)(1) To calculate a return on undepreciated capital investment, multiply the remaining undepreciated capital balance as of the beginning of the period for which you are calculating the transportation allowance by the rate of return provided in paragraph (i)(2) of this section.

(2) The rate of return is 1.3 times the industrial bond yield index for Standard & Poor's BBB bond rating. Use the monthly average rate published in "Standard & Poor's Bond Guide" for the first month of the reporting period for which the allowance applies. Calculate the rate at the beginning of each subsequent transportation allowance reporting period.

(j)(1) After a transportation system has been depreciated at or below a value equal to ten percent of your total capital investment, you may continue to include in the allowance calculation a cost equal to ten percent of your total capital investment in the transportation system multiplied by a rate

of return under paragraph (i)(2) of this section.

(2) You may apply this paragraph to a transportation system that before June 1, 2000, was depreciated at or below a value equal to ten percent of your total capital investment.

(k) Calculate the deduction for transportation costs based on your or your affiliate's cost of transporting each product through each individual transportation system. Where more than one liquid product is transported, allocate costs consistently and equitably to each of the liquid products transported. Your allocation must use the same proportion as the ratio of the volume of each liquid product (excluding waste products with no value) to the volume of all liquid products (excluding waste products with no value).

(1) You may not take an allowance for transporting lease production that is not royalty-bearing.

(2) You may propose to ONRR a cost allocation method on the basis of the values of the products transported. ONRR will approve the method if it is consistent with the purposes of the regulations in this subpart.

(1)(1) Where you transport both gaseous and liquid products through the same transportation system, you must propose a cost allocation procedure to ONRR.

(2) You may use your proposed procedure to calculate a transportation allowance until ONRR accepts or rejects your cost allocation. If ONRR rejects your cost allocation, you must amend your Form MMS-2014 for the months that you used the rejected method and pay any additional royalty and interest due.

(3) You must submit your initial proposal, including all available data, within 3 months after first claiming the allocated deductions on Form MMS-2014.

[65 FR 14088, Mar. 15, 2000, as amended at 69 FR 24977, May 5, 2004]

§ 1206.112 What adjustments and transportation allowances apply when I value oil production from my lease using NYMEX prices or ANS spot prices?

This section applies when you use NYMEX prices or ANS spot prices to

calculate the value of production under § 1206.103. As specified in this section, adjust the NYMEX price to reflect the difference in value between your lease and Cushing, Oklahoma, or adjust the ANS spot price to reflect the difference in value between your lease and the appropriate ONRR-recognized market center at which the ANS spot price is published (for example, Long Beach, California, or San Francisco, California). Paragraph (a) of this section explains how you adjust the value between the lease and the market center, and paragraph (b) of this section explains how you adjust the value between the market center and Cushing when you use NYMEX prices. Paragraph (c) of this section explains how adjustments may be made for quality differentials that are not accounted for through exchange agreements. Paragraph (d) of this section gives some examples. References in this section to “you” include your affiliates as applicable.

(a) To adjust the value between the lease and the market center:

(1)(i) For oil that you exchange at arm’s length between your lease and the market center (or between any intermediate points between those locations), you must calculate a lease-to-market center differential by the applicable location and quality differentials derived from your arm’s-length exchange agreement applicable to production during the production month.

(ii) For oil that you exchange between your lease and the market center (or between any intermediate points between those locations) under an exchange agreement that is not at arm’s length, you must obtain approval from ONRR for a location and quality differential. Until you obtain such approval, you may use the location and quality differential derived from that exchange agreement applicable to production during the production month. If ONRR prescribes a different differential, you must apply ONRR’s differential to all periods for which you used your proposed differential. You must pay any additional royalties owed resulting from using ONRR’s differential plus late payment interest from the original royalty due date, or you may report a credit for any overpaid royalties

plus interest under 30 U.S.C. 1721(h).

(2) For oil that you transport between your lease and the market center (or between any intermediate points between those locations), you may take an allowance for the cost of transporting that oil between the relevant points as determined under § 1206.110 or § 1206.111, as applicable.

(3) If you transport or exchange at arm’s length (or both transport and exchange) at least 20 percent, but not all, of your oil produced from the lease to a market center, determine the adjustment between the lease and the market center for the oil that is not transported or exchanged (or both transported and exchanged) to or through a market center as follows:

(i) Determine the volume-weighted average of the lease-to-market center adjustment calculated under paragraphs (a)(1) and (a)(2) of this section for the oil that you do transport or exchange (or both transport and exchange) from your lease to a market center.

(ii) Use that volume-weighted average lease-to-market center adjustment as the adjustment for the oil that you do not transport or exchange (or both transport and exchange) from your lease to a market center.

(4) If you transport or exchange (or both transport and exchange) less than 20 percent of the crude oil produced from your lease between the lease and a market center, you must propose to ONRR an adjustment between the lease and the market center for the portion of the oil that you do not transport or exchange (or both transport and exchange) to a market center. Until you obtain such approval, you may use your proposed adjustment. If ONRR prescribes a different adjustment, you must apply ONRR’s adjustment to all periods for which you used your proposed adjustment. You must pay any additional royalties owed resulting from using ONRR’s adjustment plus late payment interest from the original royalty due date, or you may report a credit for any overpaid royalties plus interest under 30 U.S.C. 1721(h).

(5) You may not both take a transportation allowance and use a location and quality adjustment or exchange

differential for the same oil between the same points.

(b) For oil that you value using NYMEX prices, adjust the value between the market center and Cushing, Oklahoma, as follows:

(1) If you have arm's-length exchange agreements between the market center and Cushing under which you exchange to Cushing at least 20 percent of all the oil you own at the market center during the production month, you must use the volume-weighted average of the location and quality differentials from those agreements as the adjustment between the market center and Cushing for all the oil that you produce from the leases during that production month for which that market center is used.

(2) If paragraph (b)(1) of this section does not apply, you must use the WTI differential published in an ONRR-approved publication for the market center nearest your lease, for crude oil most similar in quality to your production, as the adjustment between the market center and Cushing. (For example, for light sweet crude oil produced offshore of Louisiana, use the WTI differential for Light Louisiana Sweet crude oil at St. James, Louisiana.) After you select an ONRR-approved publication, you may not select a different publication more often than once every 2 years, unless the publication you use is no longer published or ONRR revokes its approval of the publication. If you are required to change publications, you must begin a new 2-year period.

(3) If neither paragraph (b)(1) nor (b)(2) of this section applies, you may propose an alternative differential to ONRR. Until you obtain such approval, you may use your proposed differential. If ONRR prescribes a different differential, you must apply ONRR's differential to all periods for which you used your proposed differential. You must pay any additional royalties owed resulting from using ONRR's differential plus late payment interest from the original royalty due date, or you may report a credit for any overpaid royalties plus interest under 30 U.S.C. 1721(h).

(c)(1) If you adjust for location and quality differentials or for transpor-

tation costs under paragraphs (a) and (b) of this section, also adjust the NYMEX price or ANS spot price for quality based on premiums or penalties determined by pipeline quality bank specifications at intermediate commingling points or at the market center if those points are downstream of the royalty measurement point approved by BOEMRE or BLM, as applicable. Make this adjustment only if and to the extent that such adjustments were not already included in the location and quality differentials determined from your arm's-length exchange agreements.

(2) If the quality of your oil as adjusted is still different from the quality of the representative crude oil at the market center after making the quality adjustments described in paragraphs (a), (b) and (c)(1) of this section, you may make further gravity adjustments using posted price gravity tables. If quality bank adjustments do not incorporate or provide for adjustments for sulfur content, you may make sulfur adjustments, based on the quality of the representative crude oil at the market center, of 5.0 cents per one-tenth percent difference in sulfur content, unless ONRR approves a higher adjustment.

(d) The examples in this paragraph illustrate how to apply the requirement of this section.

(1) *Example.* Assume that a Federal lessee produces crude oil from a lease near Artesia, New Mexico. Further, assume that the lessee transports the oil to Roswell, New Mexico, and then exchanges the oil to Midland, Texas. Assume the lessee refines the oil received in exchange at Midland. Assume that the NYMEX price is \$30.00/bbl, adjusted for the roll; that the WTI differential (Cushing to Midland) is $-.10/\text{bbl}$; that the lessee's exchange agreement between Roswell and Midland results in a location and quality differential of $-.08/\text{bbl}$; and that the lessee's actual cost of transporting the oil from Artesia to Roswell is $$.40/\text{bbl}$. In this example, the royalty value of the oil is $\$30.00 - \$.10 - \$.08 - \$.40 = \$29.42/\text{bbl}$.

(2) *Example.* Assume the same facts as in the example in paragraph (1), except that the lessee transports and exchanges to Midland 40 percent of the

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production from the lease near Artesia, and transports the remaining 60 percent directly to its own refinery in Ohio. In this example, the 40 percent of the production would be valued at \$29.42/bbl, as explained in the previous example. In this example, the other 60 percent also would be valued at \$29.42/bbl.

(3) *Example.* Assume that a Federal lessee produces crude oil from a lease near Bakersfield, California. Further, assume that the lessee transports the oil to Hynes Station, and then exchanges the oil to Cushing which it further exchanges with oil it refines. Assume that the ANS spot price is \$20.00/bbl, and that the lessee's actual cost of transporting the oil from Bakersfield to Hynes Station is \$.28/bbl. The lessee must request approval from ONRR for a location and quality adjustment between Hynes Station and Long Beach. For example, the lessee likely would propose using the tariff on Line 63 from Hynes Station to Long Beach as the adjustment between those points. Assume that adjustment to be \$.72, including the sulfur and gravity bank adjustments, and that ONRR approves the lessee's request. In this example, the preliminary (because the location and quality adjustment is subject to ONRR review) royalty value of the oil is $\$20.00 - \$.72 - \$.28 = \$19.00/\text{bbl}$. The fact that oil was exchanged to Cushing does not change use of ANS spot prices for royalty valuation.

[69 FR 24978, May 5, 2004]

§ 1206.113 How will ONRR identify market centers?

ONRR periodically will publish in the FEDERAL REGISTER a list of market centers. ONRR will monitor market activity and, if necessary, add to or modify the list of market centers and will publish such modifications in the FEDERAL REGISTER. ONRR will consider the following factors and conditions in specifying market centers:

- (a) Points where ONRR-approved publications publish prices useful for index purposes;
- (b) Markets served;
- (c) Input from industry and others knowledgeable in crude oil marketing and transportation;
- (d) Simplification; and

- (e) Other relevant matters.

§ 1206.114 What are my reporting requirements under an arm's-length transportation contract?

You or your affiliate must use a separate entry on Form MMS-2014 to notify ONRR of an allowance based on transportation costs you or your affiliate incur. ONRR may require you or your affiliate to submit arm's-length transportation contracts, production agreements, operating agreements, and related documents. Recordkeeping requirements are found at part 1207 of this chapter.

§ 1206.115 What are my reporting requirements under a non-arm's-length transportation arrangement?

(a) You or your affiliate must use a separate entry on Form MMS-2014 to notify ONRR of an allowance based on transportation costs you or your affiliate incur.

(b) For new transportation facilities or arrangements, base your initial deduction on estimates of allowable oil transportation costs for the applicable period. Use the most recently available operations data for the transportation system or, if such data are not available, use estimates based on data for similar transportation systems. Section 1206.117 will apply when you amend your report based on your actual costs.

(c) ONRR may require you or your affiliate to submit all data used to calculate the allowance deduction. Recordkeeping requirements are found at part 1207 of this chapter.

§ 1206.116 What interest applies if I improperly report a transportation allowance?

(a) If you or your affiliate deducts a transportation allowance on Form MMS-2014 that exceeds 50 percent of the value of the oil transported without obtaining ONRR's prior approval under § 1206.109, you must pay interest on the excess allowance amount taken from the date that amount is taken to the date you or your affiliate files an exception request that ONRR approves. If you do not file an exception request, or if ONRR does not approve your request, you must pay interest on the excess allowance amount taken from the